

## National Bank of Hungary Preview: The pause goes on

In our view, the interest rate complex will remain on hold at the National Bank of Hungary's last meeting of the year. Although the macro outlook could support easing policy, the Hungarian forint is simply not ready for such a move

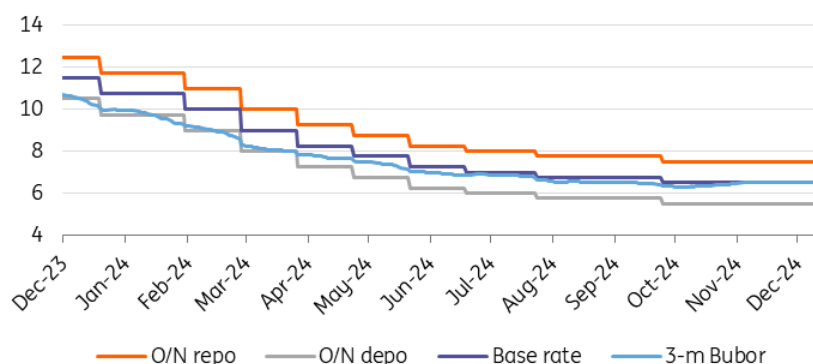


National Bank of Hungary in Budapest

### The central bank kept its rates unchanged in November

The National Bank of Hungary kept its base rate unchanged at 6.50% in November, as expected. The interest rate corridor also remained unchanged, with a range of +/- 100bp around the base rate. In line with its stability-oriented approach, this decision was driven by geopolitical tensions, risks to the inflation outlook and, most importantly, volatile financial market developments, i.e. the significant weakening of the Hungarian forint. In fact, from a monetary policy perspective, the macro background was quite positive, but the decision did not come as a big surprise due to the market stability issues. Something similar can be said about the upcoming decision in December.

## The main interest rates (%)



Source: NBH, ING

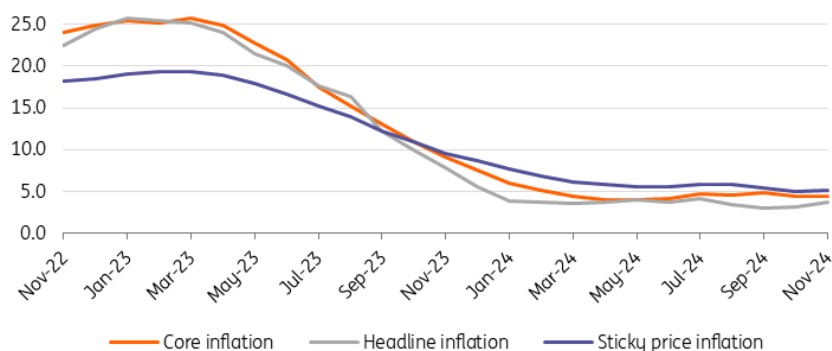
### In a vacuum, we could easily talk about easing...

Headline inflation rose by 0.5ppt to 3.7% year-on-year in November, slightly below the market and National Bank of Hungary’s expectations. The acceleration was mainly driven by further increases in food, fuel, and household energy prices, while the average price of consumer durables fell on a monthly basis, probably due to the stronger “Black Friday” sales event. All in all, the latest inflation data painted a broadly positive picture. This was reinforced by the fact that core inflation in November came in well below the path outlined by the NBH in September (4.4% YoY vs. 5.0% expected). Against this backdrop, the short-term outlook for underlying inflation is therefore encouraging compared to the outlook a month ago. In our view, such developments could stem from weaker-than-expected economic activity and the absence of demand-driven price pressures.

In terms of risk perception from a monetary policy perspective, the November budget deficit was the lowest 11-month figure since 2019. Consequently, this means that the deficit in the last month of the year could reach HUF 1,500bn, which is a significant amount, without jeopardising the target. The results show that the budget is under tight control and that this year’s deficit target is not necessarily at risk. This alone increases the probability of a smaller slippage in the 2025 budget.

As far as external balances are concerned, we have seen a slight deterioration in the third quarter and at the beginning of the fourth quarter, but it has hardly reached alarming levels. As a result, risk perceptions are unlikely to play a major role in the decision-making process. Therefore, the macroeconomic backdrop, especially given the rather weak economic activity with the second technical recession in the last three years, would allow the central bank to think or perhaps even talk about easing.

## Headline and underlying inflation measures (% YoY)



Source: HCSO, NBH, ING

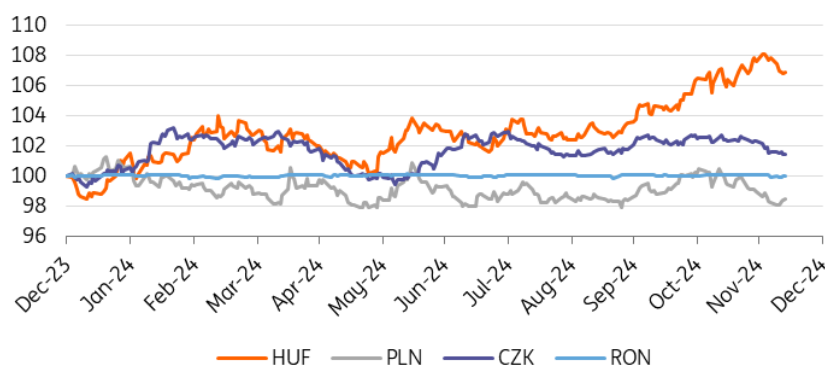
### ... but the Hungarian forint is making life difficult for policymakers

So again, under normal circumstances, the inflation picture and risk perceptions would leave some room for easing, but the instability in the financial markets has once again sealed the deal. The central bank's communication has continued to be about a cautious, patient and stability-oriented approach, and this is what the market expects. This also means that a decision to keep rates on hold will be in line with recent market expectations, which is crucial given the forint's vulnerability.

Nonetheless, the complete lack of forward guidance on easing also favours a hold in December. A cut on 17 December could come as a big surprise to market participants and send the forint back down. The EUR/HUF exchange rate is therefore now the key issue for financial market stability. Since the November meeting, the exchange rate has risen sharply to as high as 415 and has been fluctuating between 408 and 415. Compared with the September Inflation Report, the forint has depreciated significantly (by about 4-5%) against the euro and by about 11% against the dollar. This clearly pushes up the longer-term inflation outlook, and narrowing the interest rate differential in the region by cutting interest rates would only exacerbate the inflation situation by further weakening the forint.

Although the inflation data has not been as gloomy recently, we can definitely see a rising trend, and we expect this to continue in the coming months. Moreover, perceived inflation and inflation expectations have also risen, partly because of the structure of inflation (now mainly driven by higher fuel and food prices) and partly because of the weakening of the forint, which is not helping confidence indices either. Anchoring expectations is the primary objective of monetary policy in this case. Moreover, imported inflation is not only aggravated by the future development of the forint exchange rate. The inflationary path in Europe is also somewhat higher, as commodity prices (also in euro or dollar terms) are rising sharply. In particular, energy (especially gas) and agricultural commodity prices have risen sharply in recent months.

## Performance of CEE FX versus EUR (end-2023 = 100%)



Source: NBH, ING

## Our call

All in all, in the current situation we do not see any room for the central bank to ease monetary policy in the short term. In our view, the National Bank of Hungary will leave the interest rate complex unchanged at its next rate-setting meeting on 17 December. This will leave the key rate at 6.50%, which is a high conviction call. We also expect the Monetary Council to leave both ends of the interest rate corridor unchanged.

Of course, this does not mean that there will be no opportunity to restart the cycle of rate cuts in the future. If the European Central Bank accelerates its rate-cutting cycle (probably in the first half of 2025) and the regional central banks also start easing in the second half of the year, the new Monetary Council could take action as early as June without endangering the forint as a whole. We think a total of 75bp of rate cuts next year is realistic, which would be in line with the average size of easing cycles in the region.

## New staff projections

The central bank's new forecasts will certainly be interesting this time. We expect the central bank to lower its growth forecasts significantly both this year and next. It may even widen the forecast range for next year, signalling greater uncertainty. For this year's inflation forecast, a narrowing of the range is expected towards the end of the year, but the updated inflation path for the next two years will be more interesting. In the longer term, the change in the forecast is a combination of weaker demand-side inflationary pressures due to weaker growth prospects and rising inflation risks from supply-side shocks. Looking at recent developments in market forecasts as well as our own assessment of the situation, the latter effect may be stronger and the NBH may move its inflation forecast range for 2025 upwards, albeit marginally.

## Our market views

Although EUR/HUF was steady at 415 in the first week of December, the highest levels since late 2022, the last few days have brought visible relief for the forint. Friday's decision by Fitch to

upgrade the rating outlook from negative to stable was a reason for profit-taking following the heavy short positioning built up over the last two months. With global conditions being less risk-off since the US election and December usually positive for EUR/USD and CEE currencies in general, we believe HUF's worst period is behind it. Thus, tactically, we think the HUF may see some more gains before the end of the year, but NBH communication will be key. In November, the market's main takeaway was one vote for a rate cut, which triggered a sell-off. This time, the market may be ready for dovish signals of this kind accompanied by a hawkish press conference. If the NBH delivers a copy-paste press conference like in November, we believe EUR/HUF could stabilise at current levels or even see some further downside movement due to more positioning adjustments. However, in the medium-term, we remain negative on the forint and expect a move to 420 EUR/HUF next year.

Rates market seems to have been driven mainly by EUR/HUF in recent weeks and the relief in the HUF market has brought some receiving flow into the rates market. Still, the market remains in a distressed mode with little easing pricing after the strong sell-off ahead of the US election. The very near end of the curve prices in roughly three 25bp rate cuts with a terminal rate of around 5.75%. Looking beyond the two-year horizon the IRS curve very quickly prices in rate hikes and the whole curve is very flat. Although the economy and inflation continue to surprise to the downside, opening the door for NBH rate cuts, FX is the main obstacle to repricing here. We expect the relief in the HUF market to bring more repricing and the NBH press conference may be further confirmation of market normalisation. Particularly in the context of the NBH management change next March and the weak economy, we believe the curve would be fair to price in more rate cuts with a terminal rate of at least 5%. The curve should thus see some re-steepening in the coming months, in our view.

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